UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, -against- CHRISTOPHER PLAFORD, Defendant.	:	No. 16 Civ. 4511 (KPF)
SECURITIES AND EXCHANGE COMMISSION, Plaintiff, -against- STEFAN LUMIERE, Defendant.	:	No. 16 Civ. 4513 (KPF)

THE GOVERNMENT'S MEMORANDUM OF LAW IN SUPPORT OF ITS
MOTION TO INTERVENE AND FOR A STAY OF PROCEEDINGS

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PRELIMINARY STATEMENT

The United States of America, by and through the United States Attorney for the Southern District of New York ("the Government"), respectfully submits this memorandum in support of its motion (i) to intervene in the above-captioned cases, *Securities and Exchange Commission* v. *Christopher Plaford,* No. 16 Civ. 4511 (KPF) and *Securities and Exchange Commission* v. *Stefan Lumiere*, No. 16 Civ. 4513 (KPF) (together, the "Civil Actions"), pursuant to Rule 24 of the Federal Rules of Civil Procedure, and (ii) to stay civil proceedings in both cases, including Rule 26(a)(1) and other discovery in the Civil Actions, until the completion of the trial or other disposition in the parallel criminal cases, *United States* v. *Christopher Plaford*, 16 Cr. 400 (RA) and *United States* v. *Stefan Lumiere*, 16 Cr. 483 (JSR) (the "Criminal Cases").

The Criminal Cases arise from the same set of facts and circumstances that underlie the respective Civil Actions. Courts in this district frequently stay civil proceedings when there is a parallel criminal prosecution.

Christopher Plaford ("Plaford") and Stefan Lumiere ("Lumiere"), who are the defendants in the Criminal Cases and the defendants in the Civil Actions, consent to the Government's motion to intervene and for a stay of both proceedings. The Securities and Exchange Commission ("SEC") does not oppose the Government's motion to stay the Civil Actions.

BACKGROUND

On or about June 9, 2016, a criminal information (the "Plaford Information") was filed against Plaford under seal. (A copy of the Plaford Information is attached hereto as Exhibit A.) That same day, Plaford pled guilty to the charges in the Plaford Information, pursuant to a cooperation agreement with the Government. On June 15, 2016, the criminal charges were unsealed, and the SEC filed a complaint against Plaford.

On or about June 15, 2016, a criminal complaint was unsealed against Lumiere. On or about July 14, 2016, Lumiere was indicted (the "Lumiere Indictment"). (A copy of the Lumiere Indictment is attached hereto as Exhibit B.) On June 15, 2016, the SEC filed a complaint against Lumiere.

As alleged in both the Plaford Information and Lumiere Indictment, from in or about June 2011 through in or about September 2013, Plaford and Lumiere, while working for the same investment advisor ("Investment Advisor-A"), participated in a scheme to defraud investors and potential investors in a particular hedge fund managed by Investment Advisor-A (the "Fund"), by deceptively mismarking each month the value of certain securities held by the Fund. The objective of the scheme was two-fold: (1) to inflate the Fund's Net Asset Value ("NAV"); and (2) to mislead investors about the liquidity of the Fund's holdings (the "Mismarking Scheme"). Investment Advisor-A assessed performance fees to be paid by investors each year based on the Fund's profits and losses. Plaford and Lumiere's mismarking was in violation of Investment Advisor-A's internal valuation procedures and contrary to Investment Advisor-A's representations to investors. The effect of the scheme was to overstate the Fund's NAV, often by tens of millions of dollars as calculated at the end of each month, which resulted in higher payments to Investment Advisor-A and higher bonuses for Plaford and Lumiere, among other benefits. The effect of the scheme was also to deceive investors into believing that certain securities were relatively liquid and easily monetizable, when, in fact, these securities were highly illiquid investments.

The Mismarking Scheme took two forms. As to the first form of the scheme, Plaford, Lumiere and others solicited, obtained, and relied on false and fraudulent price quotes from employees of broker-dealers in order to improperly override securities prices calculated by the Fund's administrator and artificially inflate the Fund's NAV each month. By obtaining these sham quotes, Plaford and Lumiere caused a number of the Fund's securities to be misclassified in order to mislead investors about the liquidity of the securities (*i.e.*, how actively traded the securities were). Specifically, for a number of illiquid bonds, Plaford and Lumiere fraudulently caused Investment Advisor-A to assign a classification that led investors to believe that the bonds were relatively liquid, when in fact they were entirely illiquid. This was done contrary to disclosures to investors about the Fund's percentage of illiquid investments, in order to induce investors to invest in or keep their money in the Fund.

As to the second form of the scheme, Plaford and Lumiere purchased additional quantities of certain securities—in which the Fund had an established position—at a deceptively inflated price, markedly higher than the prevailing market was offering that security, in a practice known as "painting the tape." Plaford would then report that inflated price to Investment Advisor-A's accounting department for NAV purposes, which would ultimately result in higher bonuses for Plaford and Lumiere.

In addition, Plaford was also charged (in the same SEC complaint that charges Plaford with participating in the Mismarking Scheme) with participating in two schemes involving the theft of confidential and material non-public government information to trade securities.[1] First, Plaford was charged with participating in a scheme to convert to his own use material non-public information from the FDA concerning, among other things, the FDA's internal deliberations regarding the approval of generic drug applications for the purpose of making profitable securities transactions. Second, Plaford was charged with participating in a scheme to obtain and convert to his own use material non-public information from the Centers for Medicaid and Medicare Services

[1] Lumiere is only charged with participating in the Mismarking Scheme.

("CMS") concerning, among other things, internal deliberations and upcoming actions of CMS regarding the reimbursement for and coverage of certain products and services for the purpose of making profitable securities transactions.

ARGUMENT

This Court should grant this unopposed application for a stay of the Civil Actions for several reasons. First, permitting discovery in the Civil Actions could circumvent the constraints imposed on discovery in criminal cases. Second, there is no prejudice to the parties to the Civil Actions that would arise from staying the action; in fact, both defendants consent to the stay and the SEC does not oppose the stay. Third, staying the Civil Actions pending the conclusion of the Criminal Cases would likely be more efficient and preserves the Court's resources because many of the issues presented by the Civil Actions will be (and have already been) resolved in the Criminal Cases.

I. The Government Should be Granted Permission to Intervene

Under Rule 24(a)(2) of the Federal Rules of Civil Procedure, anyone may intervene as of right in an action when the applicant "claims an interest relating to the property or transaction which is the subject of the action" and the applicant is so situated that "disposing of the action may as a practical matter impair or impede the movant's ability to protect its interests . . . ." Alternatively, Rule 24(b)(2) provides for permissive intervention when the movant "has a claim or defense that shares with the main action a common question of law or fact." The Government respectfully submits that its application satisfies both of these provisions.

As a general rule, courts "have allowed the government to intervene in civil actions – especially when the government wishes to do so for the limited purpose of moving to stay discovery." *Twenty First Century Corp*. v. *LaBianca*, 801 F. Supp. 1007, 1009 (E.D.N.Y. 1992);

see also SEC v. *Credit Bancorp*., 297 F.3d 127, 130 (2d Cir. 2002). The Government has a "discernible interest in intervening in order to prevent discovery in a civil case from being used to circumvent the more limited scope of discovery in the criminal matter." *SEC* v. *Chestman*, 861 F.2d 49, 50 (2d Cir. 1988). Indeed, "[i]t is well established that the United States Attorney may intervene in a federal civil action to seek a stay of discovery when there is a parallel criminal proceeding, which is . . . already underway that involves common questions of law or fact." *SEC* v. *Downe*, No. 92 Civ. 4092 (PKL), 1993 WL 22126, at *11 (S.D.N.Y. June 26, 1993); *see also First Merchants Enterprise, Inc*. v. *Shannon*, No. 88 Civ. 8254 (CSH), 1989 WL 25214 (S.D.N.Y. Mar. 16, 1989) (allowing intervention); *Governor of the Fed'l Reserve System* v. *Pharaon*, 140 F.R.D. 634, 638 (S.D.N.Y. 1991) (same).

As an initial matter, intervention is warranted because the Government's interests in upholding the public interest in enforcement of the criminal laws cannot be protected adequately by the existing parties in this civil litigation, none of whom represent the Government's interests with respect to the investigation and enforcement of federal criminal statutes. *See Bureerong* v. *Uvawas*, 167 F.R.D. 83 (C.D.Cal. 1996) ("the Government's prosecutorial and investigative interest is not adequately protected by any of the civil parties . . . . Clearly neither the plaintiff or the defendants have this identical interest.").

Moreover, a trial in the civil case against Lumiere in advance of a trial in the related criminal case against Lumiere could impair or impede the Government's ability to protect its interests in the enforcement of federal criminal law. The civil action against Lumiere and the criminal case against him arise from the same fraudulent Mismarking Scheme. Holding a civil trial before a criminal trial would create the possibility that there will be two trials covering the same fraudulent acts with the same witnesses. This raises the probability that witnesses will be unnecessarily burdened by having to testify twice.

Although Plaford is unlikely to proceed to trial in his SEC matter given his guilty plea, the taking of discovery and depositions in his SEC matter (for the purposes of determining Plaford's financial gain, for example), could inure to the detriment of the Government in the criminal case against Lumiere, by creating—and requiring the production of—witness statements that otherwise would not be produced to Lumiere until closer to trial. In light of those circumstances, the Government respectfully submits that its application to intervene should be granted.

II. A Stay of the Civil Actions is Warranted

This Court has the inherent power to stay a civil proceeding in the interests of justice pending the completion of the parallel criminal trial. *Kashi* v. *Gratsos*, 790 F.2d 1050, 1057 (2d Cir. 1986) ("[A] court may decide in its discretion to stay civil proceedings . . . when the interests of justice seem . . . to require such action.") (internal citations and quotations omitted). When considering whether to grant a stay, courts balance the following factors:

> (1) the extent to which the issues in the criminal case overlap with those presented in the civil case; (2) the status of the case, including whether the defendants have been indicted; (3) the private interests of the plaintiffs in proceeding expeditiously weighed against the prejudice to plaintiffs caused by the delay; (4) the private interests of and burden on the defendants; (5) the interest of the court; and (6) the public interest.

SEC v. *Treadway*, No. 04 Civ. 3464(VM)(JCF), 2005 WL 713826, at *2-*3 (S.D.N.Y. March 30, 2005) (quoting *In re Worldcom, Inc. Secur. Litig.*, Nos. 02 Civ. 3288, 02 Civ. 4816, 2002 WL 31729501, at *4 (S.D.N.Y. Dec. 5, 2002))); *see also Volmar Distrib., Inc.* v. *New York Post Co., Inc.*, 152 F.R.D. 36, 39 (S.D.N.Y. 1993) (listing similar factors). "Balancing these factors is a case-by-case determination." *Volmar Distrib*, 152 F.R.D. at 39. An analysis of these factors in this case weighs in favor of granting the stay sought by the Government.

A. The Extent of Overlap

The identity of issues underlying all the cases weighs heavily in favor of a stay. "The most important factor at the threshold is the degree to which the civil issues overlap with the criminal issues." *Volmar Distrib.*, 152 F.R.D. at 39 (*citing* Judge Milton Pollack, *Parallel Civil and Criminal Proceedings*, 129 F.R.D. 201, 203 (S.D.N.Y. 1989)); *see also Parker* v. *Dawson*, No. 06 Civ. 6191 (JFB), 2007 WL 2462677 (Aug. 27, 2007 E.D.N.Y.) at *4 (same); *United States* v. *One 1964 Cadillac Coupe DeVille*, 41 F.R.D. 352, 353 (S.D.N.Y. 1966) ("Where both civil and criminal proceedings arise out of the same or related transactions the government is ordinarily entitled to a stay of all discovery in the civil case until disposition of the criminal matter.").

Here, the criminal and civil actions against Lumiere describe the same fraudulent Mismarking Scheme to inflate the value of securities held by the Fund during the same time period. In short, the cases involve virtually identical facts and issues regarding the Mismarking Scheme.

Similarly, the criminal and civil actions against Plaford describe Plaford's participation in the same fraudulent Mismarking Scheme. Plaford was also criminally charged with conduct unrelated to the Mismarking Scheme, namely, for stealing confidential and material non-public government information to trade securities. Again, the allegations in the Plaford Information and the SEC Complaint as to this conduct are virtually identical, and also involve many of the same facts and issues.

B. The Status of the Criminal Case

The return of an indictment in the criminal case is also a factor that weighs in favor of a stay. "Courts generally decline to stay civil proceedings when a related criminal matter is still in the investigatory stage." *Treadway*, 2005 WL 713826 at *3. On the other hand, "[t]he weight of authority in this Circuit indicates that courts will stay a civil proceeding when the criminal investigation has ripened into an indictment." *In re Par Pharm, Inc. Sec. Litig.*, 133 F.R.D. 12, 13 (S.D.N.Y. 1990). As the Court explained in *Trustees of Plumbers and Pipefitters Nat'l Pension Fund, et al.* v. *Transworld Mechanical, Inc.*:

> A stay of a civil case is most appropriate when a party to the civil case has already been indicted for the same conduct for two reasons: first, the likelihood that a defendant may make incriminating statements is greatest after an indictment has issued, and second, the prejudice to the plaintiffs in the civil case is reduced since the criminal case will likely be quickly resolved.

886 F. Supp. 1134, 1139 (S.D.N.Y. 1995).

Lumiere has been indicted. Plaford has also been indicted, and has already pled guilty pursuant to a cooperation agreement with Government. Thus, this factor also militates in favor of a stay.

C. The Potential Prejudice to the Parties

There is very little, if any, prejudice to the parties that would result from the stay sought by the Government. Defendants in parallel criminal cases typically have an interest in not being deposed because if they assert their Fifth Amendment privilege, an adverse inference may be drawn against them in the civil case. *See Baxter* v. *Palmigiano*, 425 U.S. 308, 318 (1976) (noting that Fifth Amendment does not forbid adverse inferences against parties to civil actions). But as one district court recently noted, "[t]he specter of parties and witnesses invoking their Fifth Amendment rights would render discovery largely one-sided; the SEC would produce scores of documents and witness testimony only to be precluded from gathering reciprocal discovery from the defendants." *SEC* v. *Nicholas*, 569 F.Supp. 2d. 1065, 1070 (C.D.Cal. 2008); *see also SEC* v. *Saad*, 229 F.R.D. 90, 91 (S.D.N.Y. 2006) (JSR) (noting that in a prior civil case, *SEC* v. *The Oakford Corporation*, 181 F.R.D. 269 (S.D.N.Y. 1998) (JSR), Judge Rakoff had stayed deposition discovery because there was a high likelihood that invocations of the Fifth Amendment privilege would "play havoc with the orderly conduct" of the depositions, but Judge Rakoff allowed depositions to proceed in *Saad* because none of the defendants was going to invoke the Fifth Amendment privilege). As a result, in this instance, granting a stay of the civil cases to permit the criminal case to proceed to its conclusion would actually benefit Lumiere, since granting a stay of the civil case against Lumiere would for now obviate forcing him to make the choice between being prejudiced in the civil cases by the assertion of her Fifth Amendment rights or being prejudiced in the criminal case if he waives those rights. For different reasons, a stay would not prejudice Plaford, who has pled guilty in the criminal case against him pursuant to a cooperation agreement, and is likely to resolve the SEC action against him shortly.[2]

D. The Public Interest

The Government and the public have an important interest in insuring that civil discovery is not used to circumvent the restrictions that pertain to criminal discovery. Rule 16 of the Federal Rules of Criminal Procedure expressly limits the documents that are subject to discovery in a criminal case and further states that it does not "authorize the discovery . . . of statements made by government witnesses or prospective government witnesses except as provided in 18 U.S.C. § 3500." Fed. R. Crim. P. 16(a)(2). Title 18, United States Code, Section 3500 provides that in criminal cases, the statements of Government witnesses—such as witness testimony taken by the SEC—shall not be "the subject of subpoena, discovery, or inspection until said witness

[2] The Government understands from speaking with Plaford's defense counsel that Plaford intends to settle with the SEC, but requires some additional time to finalize the terms of that settlement.

has testified on direct examination in the trial of the case." The public policy against premature disclosure of the Government's criminal case is so strong that courts are without power to order early production of witness statements. *See United States* v. *Taylor*, 802 F.2d 1108, 1117-18 (9th Cir. 1986). Moreover, except under "exceptional circumstances" and pursuant to court order, the criminal rules do not provide for depositions as a means of discovery. *See In re Ahead By A Length, Inc.*, 78 B.R. 708, 711 (S.D.N.Y. 1987); Fed. R. Crim. P. 15.

Courts repeatedly have recognized that a civil litigant should not be allowed to use civil discovery to avoid the restrictions that would otherwise pertain in criminal discovery to a criminal defendant. *See SEC* v. *Beacon Hill Asset Management LLC*, No. 02 Civ. 8855 (LAK), 2003 WL 554618, at *1 (S.D.N.Y. Feb. 27, 2003) (in context of request for civil stay of discovery due to pending criminal investigation, "[t]he principal concern with respect to prejudicing the government's criminal investigation is that its targets might abuse civil discovery to circumvent limitations on discovery in criminal cases"); *Phillip Morris Inc.* v. *Heinrich*, No. 95 Civ. 328 (LMM), 1996 WL 363156, at *19 (S.D.N.Y. June 28, 1996) (without a stay, defendants "may have an opportunity to gain evidence to which they are not entitled under criminal discovery rules"); *Governor of the Fed'l Reserve System* v. *Pharaon*, 140 F.R.D. 634, 639 (S.D.N.Y. 1991) ("A litigant should not be allowed to make use of the liberal discovery procedures applicable to a civil suit as a dodge to avoid the restrictions on criminal discovery and thereby obtain documents he would not otherwise be entitled to for use in his criminal trial") (quoting *Campbell* v. *Eastland*, 307 F.2d 478, 487 (5th Cir. 1952)); *In re Ivan F. Boesky Securities Litig.*, 128 F.R.D. 47, 49 (S.D.N.Y. 1989) ("the public interest in the criminal case is entitled to precedence over the civil litigant").

E. **The Interests of the Courts**

Considerations of judicial economy also weigh in favor of granting a stay. The resolution of the criminal case against Lumiere will simplify the civil action. *See SEC* v. *Contorinis*, 2012 WL 512626 (S.D.N.Y. Feb. 3, 2012) ("Courts in this district have consistently found that a defendant convicted of securities fraud in a criminal proceeding is collaterally estopped from relitigating the underlying facts in a subsequent civil proceeding."); *Twenty First Century Corp.* v. *LaBianca*, 801 F. Supp. 1007 (recognizing judicial economy as a factor to be considered); *Brock* v. *Tolkow*, 109 F.R.D. 116, 120 (E.D.N.Y. 1985) (noting that resolution of the criminal case "might reduce scope of discovery in the civil case and otherwise simplify the issues"). As to Plaford, he has already pled guilty in his criminal case, and will likely soon finalize a settlement with the SEC, without the need for judicial intervention.

CONCLUSION

In light of the strong public interest in preventing the civil discovery rules from being subverted into a device for improperly obtaining discovery in criminal cases; the lack of any opposition to the motion by the parties, reflecting the lack of prejudice to the parties; the fact that no trial date in the Civil Actions has been set; the likelihood that resolution of the Criminal Cases will resolve issues in the Civil Actions and to assure that the Government's ability to prosecute the criminal case against Lumiere is not undermined, the Government respectfully submits that the stay requested by the Government—to which the defendants consent and which the SEC does not oppose—should be granted.

Dated: New York, New York
July 19, 2016

Respectfully submitted,

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